

BEFORE THE STATE TAX APPEAL BOARD  
OF THE STATE OF MONTANA

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JEFFREY C. AND KELLY O. STONE,	)	DOCKET NO.: IT-1997-1
Appellants,	)	
	)	
-vs-	)	
	)	
THE DEPARTMENT OF REVENUE	)	FINDINGS OF FACT,
OF THE STATE OF MONTANA,	)	CONCLUSIONS OF LAW,
	)	ORDER and OPPORTUNITY
Respondent.	)	<u>FOR JUDICIAL REVIEW</u>

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The above-entitled appeal was heard on the 9th day of September, 1997 in Bozeman, Montana in accordance with the order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was given as required by law.

Kelly Stone, taxpayer, and Donald S. Fletcher, tax consultant, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Revenue Agent James S. Moody and Bureau Chief Robert Turner, presented testimony in opposition to the appeal. Testimony was presented and exhibits were received. A schedule for post-hearing submissions was established: upon the request of Donald Fletcher, he was granted 60 days for a post-hearing submission on the taxpayers' behalf; the DOR was granted a further 30 days to respond.

Upon receipt of a submission signed by the taxpayers

rather than Mr. Fletcher and a response from the DOR, the Board then took the appeal under advisement.

The Board, having fully considered the testimony, exhibits, and all things and matters presented to it by all parties, finds and concludes as follows:

#### **STATEMENT OF THE ISSUE**

The taxpayers, JEFFREY C. and KELLY O. STONE are appealing the Final Agency Decision of the DOR to disallow a portion of business expenses deducted on Schedule C of their 1994 Individual Tax Return. The DOR submitted that some expenses were partially or fully disallowed because of one or more of the following reasons: 1) the expenses were not properly substantiated as required by law; or 2) the expenses could not be distinguished between personal use and business use; and 3) the expenses were not allowable business deductions under the law.

#### **FINDINGS OF FACT**

1. Due, proper, and sufficient notice was given of this matter and of the time and place of the hearing. All parties were afforded the opportunity to present evidence, oral and documentary.

2. As a result of an audit of the taxpayers' 1994

individual income tax return, the DOR disallowed a portion of the business expenses deducted on Schedule C and issued to the taxpayers an assessment of additional tax and interest. On July 9, 1996, the DOR had an informal conference with the taxpayers.

3. The taxpayers appealed the assessment to the DOR Bureau Chief of the Income & Miscellaneous Tax Division, and a Division Administrator's Informal Decision upholding the assessment was issued on September 30, 1996.

4. The taxpayers appealed the Division Administrator's decision to the DOR Director and a Final Agency Decision upholding the assessment was issued by the Director on January 30, 1997.

5. The taxpayers appealed the Director's decision to this Board on February 26, 1997.

#### **TAXPAYERS' CONTENTIONS**

The taxpayer testified that she and her husband operate an appliance repair business in conjunction with two smaller business ventures. The taxpayer described that her husband operates his appliance repair shop in one location, and she does the record keeping at a separate location in a home office.

The taxpayer presented summary sheets describing business expense deductions.(TP Ex 1-3) In a separate binder she offered, for the Board's examination, original receipts and canceled checks for expenses incurred. She testified as to the necessity of or business relationship to several deductions sought. For example, she stated she deemed their dogs and cats necessary for security purposes. The taxpayer testified as to the business purposes of several memberships, i.e. investment club, bowling league, and Museum of the Rockies, etc.. She stated that, during the audit year, she made cash payments or other agreed upon reimbursements, to include restaurant meals, to her children and their friend in payment for contract labor. This labor was for various jobs in the shop and office. The taxpayer described various other expenditures made which she deemed were necessary for operation of her home office and others she categorized as deductible as business entertainment expenses.

A copy of the taxpayers' 1994 Individual Income Tax Return was submitted.(TP Ex 4) Mr. Fletcher testified that, after a review prompted by the tax audit, additional business expenses were identified.

The brief signed by the taxpayers was submitted as a

post-hearing submission. This brief provided the board a series of "statutes and rulings, and published opinions" presented to support their claim for deductible expenses.

#### **DEPARTMENT OF REVENUE'S CONTENTIONS**

The DOR contended that there was not proper substantiation for many of the expenditures claimed by the taxpayers as business deductions. The DOR submitted that, in numerous instances, it was not possible to distinguish between the personal or business nature of those expenditures. The DOR testified that many of the deductions which were claimed by the taxpayers were not allowable business deductions: did not meet the test of being ordinary and necessary business expenditures. The DOR stated in its post-hearing brief:

Both tests of **ordinary and necessary** must be met to be an allowed deduction. In addition, records must be maintained to support the claims. Special requirements exist for certain items; business use of auto, home office deductions, and business entertainment.

The DOR pointed out that their auditor reviewed every receipt presented for audit. An opportunity was given to the taxpayers, at that time, to further explain expenses. Some additional expenses were allowed after explanations were made by the taxpayer. Using taxpayer testimony and other supporting

information, allowances were given for some expenditures, such as auto expenses, even though adequate records were not available.

### **DISCUSSION**

The issue before this Board is to determine if the business expenses claimed by the taxpayers on Schedule C of their 1994 Individual Tax Return were allowable business deductions under the law.

This Board concurs with the DOR that many of the deductions claimed by the taxpayers were not allowable business deductions and did not meet the test of being ordinary and necessary to carry on their business. This Board further concurs that the records presented were inadequate to support deductions claimed. It is this Board's opinion that, in fact, it is clear many deductions were personal living expenses of the taxpayers and, as such, are specifically ineligible as deductions under the law.

### **CONCLUSIONS OF LAW**

1. The State Tax Appeal Board has jurisdiction over this matter. §15-2-302 MCA

2. The business purpose or business relationship of allowable income tax deductions must be substantiated.

Publications 17 and 334, IRS

3. Income tax deductions are allowable for expenses paid or incurred during a taxable year if those expenses are ordinary and necessary to carry on a trade or business. Section 162, IRC

4. If determined to be incorrect, the return of a taxpayer may be revised by the Department of Revenue. §15-30-145

**ORDER**

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the assessment of additional tax and interest for tax year 1994 as determined by the Department of Revenue is properly due and owing by the taxpayers for tax year 1994.

Dated this 11th day of December, 1997.

BY ORDER OF THE  
STATE TAX APPEAL BOARD

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PATRICK E. MCKELVEY, Chairman

( S E A L )

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GREGORY A. THORNQUIST, Member

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LINDA L. VAUGHEY, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.